Spotlight on Pensions
PRESENTS
Le Grand View
DECEMBER 2022

Pension schemes – true eco-warriors?

The iconic pictures of the earth taken from lunar orbit by NASA's Artemis spacecraft provide another reminder of how our blue planet sits exposed in the vastness of a black universe. It is also a stark reminder of the importance of our home – there is no other and we must take care of it.

The message conveyed by those pictures provided a timely backdrop to the COP 27 convention. Last year's COP 26 in Glasgow saw agreement on adopting measures to limit the rise in global temperatures to 1.5 degrees Celsius, the objective set by the Paris Agreement at COP 21 in 2015. However, there was disappointment at COP 27 amongst many delegates and onlookers when measures previously expected to be adopted were diluted. In particular, the extent to which governments will allow the use of fossil fuels to continue in the future was greater than many had hoped and expected.

Indeed, perhaps partly reflecting recognition of the practical difficulties in cutting back fossil fuel use, at one point there was concern that the 1.5-degree commitment itself would be diluted. In the end that did not happen, but it is another reminder of the challenges ahead for human civilisation as currently configured, to make changes to meet that global target.

Making changes

Change involves cost. Change on the scale required to meet the global ambitions agreed at COP 26 will involve massive economic cost. However, that is likely to be dwarfed over time by the value of damage - economic and other – which will surely result from not making the required changes. A major hurdle is that the change costs must be borne now, with implications for everyone's finances.

Small wonder then that there is reluctance to move "too far too fast". However, past inaction has exacerbated the impact of actions needed now. The amount of change required in order to meet the agreed deadlines increases with each year that action is deferred. The targets were always ambitious, but they are becoming ever more so.

Governments, businesses and individuals need to be able to make changes in a planned and controlled manner over a timeframe allowing management of the costs without causing major social and economic disruption. Despite the urgency of the climate issue, planned and controlled change is still the way forward. Knee-jerk changes that bring civilisation to a halt would only be counterproductive, resulting in uncontrolled reactions that bring their own problems.

Achieving a managed transition becomes even more challenging in times of difficult economic environments, such as are being encountered currently. However, it is clear that the consequences from not acting will impact us all: similarly we will all need to be involved in the solutions.

Pensions responsibilities

Funded pension schemes are key players in driving change. The size of the funds that they own or control make them investors with potential to exercise significant influence over both the domestic and wider global business communities. This puts them in a position of responsibility in respect of global climate management.

Responsibility begins closer to home, in respect of the climate-related risks and opportunities for their own members. Aside from the purely economic issues, there is arguably a moral imperative to contribute to efforts to ensure that the world will be a habitable place when their members reach retirement.

Surveys consistently show that members are firmly of this view. Schemes must respond and be true eco-warriors.

Government drivers

As a signatory to the Paris and later COP agreements, the UK Government is implementing a policy of legislation to drive change specifically in the UK, with consequential global influence where possible. Unsurprisingly pension schemes feature strongly in the policy.

The Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021 (as amended) and the Occupational Pension Schemes (Climate Change Governance and Reporting) (Miscellaneous Provisions and Amendments) Regulations 2021 require affected schemes to identify and assess the impact of (on an ongoing basis), climate-related risks and opportunities affecting the investment strategy (and funding strategy where there is one) over the short, medium and long term. They impose requirements relating to reporting in line with the Task Force on Climate-related Financial Disclosures (TCFD) recommendations, to improve both the quality of governance and the level of action by trustees in identifying, assessing and managing climate risk

Affected trustees must produce a detailed report, signed by the chair, containing specified information in connection with their compliance of these requirements. From October 2022 the requirements apply to schemes with £1bn or more of relevant assets.

These will trickle down to smaller schemes over the next few years, with schemes coming later hopefully benefitting from the experiences of the larger ones. Given both the importance of the subject and the amount of work schemes will need to do in response, it would be advisable for all schemes to keep appraised of developments here and to plan their own response as early as possible.

Further assistance is available from non-statutory guidance drafted by The Pensions Climate Risk Industry Group (a group formed in 2019 to provide cross-industry guidance to help trustees to manage their legal responsibilities in this area). The guidance aims to help trustees evaluate the way in which climate-related risks and opportunities may affect their strategies by making use of the TCFD recommendations.

> ***Aside from the purely economic issues, there is arguably a moral imperative to contribute to efforts to ensure that the world will be a habitable place when their members reach retirement.***

Regulators helping

Regulators themselves are similarly learning on the job and sharing their knowledge. They recognise the immense task faced by those responsible for schemes' investment to acquire and apply knowledge in this difficult area and are providing guidance to help schemes meet their new obligations.

Essential reading in this respect is The Pensions Regulator's guidance document "Governance and reporting of climate-related risks and opportunities". After setting out trustees' legal duties, it contains an appendix which provides a step-by-step example of following the climate change guidance.

New skills required

Discharging these responsibilities presents new challenges for trustees, as it does for many others. The science of climate control is relatively new, complicated and still developing. This can lead to conflicting guidance on the most effective solutions, which does not help hard-pressed trustees to understand the issues fully and develop an appropriate response within their portfolio.

For example, for many years tree planting was seen as the natural process of choice for carbon capture. Numerous tree-planting schemes have been implemented by businesses in the belief that they were fully offsetting the damage caused by their carbon emissions, allowing continuation of business as usual with a clear conscience.

However, scientific opinion appears to be changing and shifting instead to such things as the recreation of wetlands including peat bogs and the redevelopment of coastal kelp beds as being more effective natural carbon capture tools. Even with these changes, the cumulative effectiveness of such schemes by themselves are unlikely adequately to offset current global carbon emissions (which are increasing) to the extent necessary to meet the challenging COP 26 promises.

Genuine greenness

This constant reassessment of the science adds to the difficulties faced by businesses to establish and maintain genuine green credentials. It also undermines efforts to provide accurate and consistent information to enable investors such as pension schemes to assess business' green claims in order to set and meet their own green targets.

Given the difficulties involved it is perhaps not surprising that that there will be some who are prepared to consider shortcuts and to give an impression of following a green agenda while in reality doing nothing of the sort (a process known as "greenwashing"). This, whether deliberate or unintentional, presents a further hurdle for trustees and managers to overcome to be sure that they are indeed achieving their own green targets. Nevertheless, schemes must apply themselves to the difficult task of cutting through any misinformation to identify the truth that lies behind.

Although sympathetic to the problem, regulators will be keeping up pressure on schemes to do everything reasonably possible to obtain accurate information to inform their climate change plans. They are however taking steps to address key problem issues. The FCA, for example, has published a consultation document CP22/20 containing new proposals designed to crack down on greenwashing. This includes sustainable investment labels, disclosure requirements and restrictions on the use of sustainability-related terms in product naming and marketing. This is an area of developing focus, with proposals to pension products likely in due course.

True Eco-warriors?

Despite these and other initiatives to help schemes, the task of playing a full part in the fight against climate change remains daunting. Pension schemes are not expected to combat climate change, but their participation in the wider effort is essential. Given all the other pressures on schemes at the moment, even this level of involvement may seem an unwelcome burden – especially when it appears that many other players are not pulling their weight.

However, given the importance of the issue it is right that schemes should be doing what they reasonably can, when they can. That may not involve sitting on motorway gantries or throwing soup over paintings, but in their own quiet way schemes are increasingly working to save the planet through a focus on the financial security of their members.

Pendragon
part of Wilmington Intelligence